

**SCOTTISH WIDOWS**  
preparation is everything  
*official pensions and investment provider*



# Your guide to with-profits



Important information about investing  
in our With-Profits Growth Fund using  
one of our Flexible Options Bonds.

We have written this guide to give you more information about investing in our With-Profits Growth Fund using one of our Flexible Options Bonds.

This guide explains how the With-Profits Growth Fund works. You should read through all of this document as it contains important information about your bond, but here is a brief summary.

When you invest your money, it is pooled with the money invested by other investors in part of our with-profits fund. What you get back from your bond depends on the fortunes of the with-profits fund, in particular how well the investments have done in the relevant part of the fund. Your with-profits investment:

- has guaranteed minimum values at the times explained later in this guide;
- may have bonuses added to these guaranteed minimum values; and
- will normally be cushioned from the daily ups and downs of the stockmarket (we call this 'smoothing').

After meeting its obligations, the with-profits fund will over time be distributed in full to with-profits investors. Our aim is that different groups of investors receive their fair share of the fund.

This guide is a summary of a longer, more detailed, document called our Principles and Practices of Financial Management ('PPFM'). We have tried to make sure that this guide accurately reflects the PPFM. But the PPFM will apply if there is any difference between the information in it and the information in this guide.

The full PPFM is on our website at **[www.scottishwidows.co.uk/PPFM](http://www.scottishwidows.co.uk/PPFM)**, or you can ask us to send you a copy. Our address is given at the end of this guide in the section "How can I get more information?".

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The With-Profits Growth Fund is just one of the investment choices we offer. It is possible that only some of your money is invested in the With-Profits Growth Fund. This guide only covers the With-Profits Growth Fund part of your investment.

# What is meant by With-Profits Growth?

We use the term 'With-Profits Growth' to mean a type of investment. It provides medium to long-term growth potential with some guarantees (see "What are the guarantees?" on page 4). By medium to long-term we mean investments that last at least 5 years.

In return for your investment in the With-Profits Growth Fund we add With-Profits Growth units to your bond. Your units will stay With-Profits Growth units until they are cashed in when one of the following happens:

- you cash in all or part of your bond;
- we cash in units to pay any regular withdrawals you make;
- you die; or
- you switch all or part of your investment from the With-Profits Growth Fund to other funds.

The units we have added to your bond have a guaranteed minimum value in some circumstances. A description of this guarantee and the circumstances when it applies is given in "What are the guarantees?" on page 4. We may add regular bonus to your units, which you will see as an increase in their value (or 'bid price'). This increases your guarantees. We may also add final bonus when your With-Profits Growth units are cashed in. Further information on bonuses is given in "What types of bonus may be added to my bond?" on page 5. When guarantees do not apply we may make a 'market value reduction' (see page 10).

Your money less any initial charges is pooled with the money invested by other investors. While you have With-Profits Growth units, it is pooled in part of our with-profits fund called the With-Profits Growth Fund. Our approach to managing our with-profits fund as a whole and the With-Profits Growth Fund can change from time to time.

## The With-Profits Growth Fund

The With-Profits Growth Fund invests in a mix of assets such as company shares, property, bonds and cash deposits. Bonds are a type of loan, usually to the Government or companies. You may have heard Government bonds referred to as gilts. The proportion of the With-Profits Growth Fund that is put into each of these different types of asset will vary over time. The mix of assets is different to other parts of the with-profits fund.

While shares and property have usually risen more in value than bonds and cash over long periods such as 20 years, the return has also been much more variable. One year the investment may do very well, but the next could see a big fall in value – this is often called ‘investment risk’.

Most of the With-Profits Growth assets are invested with the aim of providing good returns over the long run. We call these the ‘core assets’ (see “Investment performance” on page 12). The rest are managed quite differently as part of the process of paying for guarantees (see “Guarantees” on page 12).

## Your group

When managing the With-Profits Growth Fund we often look separately at different groups of investors. The group you’ll be in will depend on when you started to invest in the With-Profits Growth Fund. If you invest in the With-Profits Growth Fund at different times using your bond, each of those investments could be in a different group.

## The shareholders

Scottish Widows plc is a ‘proprietary company’. This means that we have shareholders. Our shareholders receive the charges that we make on bonds like yours and in return meet the cost of looking after your bond.

# What are the guarantees?

We guarantee that each unit added to your bond will have a minimum value in the circumstances set out below. This value is called the 'bid price' of the unit. It is a minimum amount and we may pay out more than this.

The circumstances when these guarantees apply are:

- if you die while you still have With-Profits Growth units; and
- when we cash in units to pay any fixed regular withdrawals you make (unless the exceptions listed below apply).

For simplicity in this guide we will refer to all of the circumstances with the phrase 'when guarantees apply'.

The guarantees do not apply at other times and the guarantee on fixed regular withdrawals may not apply if you:

- chose them after the start of your bond;
- started them after the first year of your bond; or
- changed their level.

If you decide to start or change the withdrawals please let us know shortly before you want the change to happen. We will then tell you whether the guarantee will apply or not. There are limits on the levels of fixed regular withdrawals you can take.

If only some of your money is invested in the With-Profits Growth Fund, the guarantee only applies to the With-Profits Growth units.

# What types of bonus may be added to my bond?

Two types of bonus may be added to your With-Profits Growth units:

- regular bonus, which we may add daily as permanent increases in the guarantees that apply to your With-Profits Growth units; and
- final bonus, which we may add on top of those guaranteed amounts when your With-Profits Growth units are cashed in or if you die.

Different groups of investors may have different levels of each type of bonus. For instance, we set separate rates of regular bonus for units bought before 23 March 2005 and those bought later. We usually decide levels of regular and final bonus twice a year, but we may sometimes change them at other times. Future rates of bonus are not guaranteed.

The yearly statement we send you includes information about the current bonus rates for your group.

# How do you decide the bonuses?

Regular bonuses and final bonuses have different purposes, and we decide them differently.

## Regular bonus

Over time the regular bonuses increase the bid-price of the With-Profits Growth units in your bond. This increases the guarantees.

The size of the regular bonus depends on the investment return on the core assets (see “Investment performance” on page 12) over the last 2 years. Although, we may consider a shorter period for those groups of bonds that started within the last 2 years. We reduce this return for:

- tax;
- the charges we make to cover the cost of managing your bond; and
- the deductions made as part of the process of paying for guarantees.

The regular bonus is then calculated as three-quarters of the average yearly return, after those reductions. We expect higher-risk assets to give a better, but less predictable, return over the long term. If we were to set rates of regular bonus at higher levels, we’d have to invest more of the with-profits fund in more predictable lower-risk assets (see “Investment performance” on page 12). We would then expect to have less to pay out to investors.

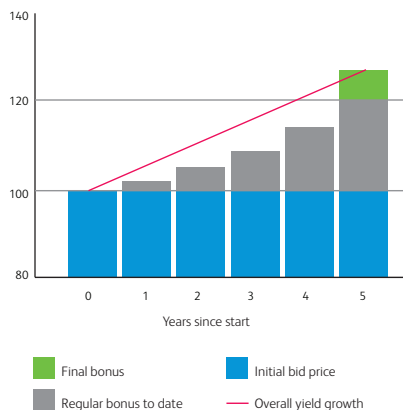
We restrict the rate of regular bonus so that it does not vary by more than 1% over 6 months. We may however set a lower rate of regular bonus when it is necessary to limit losses to the With-Profits Growth Fund. The regular bonus has a maximum level of 5%.

## Final bonus

Final bonus may be added to top up the bid price of units when units are cashed in. We explain in the following paragraphs that any final bonus we pay you depends on an 'overall yield'. How we set overall yields, usually every six months, is described later.

We apply the relevant overall yield to the bid price at which you bought each of your units. We allow for the exact period of years and days between when you originally invested in that unit and the date of the payout. We pay a final bonus if the amount we have already guaranteed to pay is less than the result of applying the overall yield. In other words, the final bonus 'tops up' what investors get from their With-Profits Growth units.

The graph below shows how this works in an example. It shows the final bonus for 100 With-Profits Growth units held in a bond for five years. It assumes that each unit had a bid price of £1 at the start. The graph then shows regular bonus of 3% added in each of the first 3 years and 4% in each of the last 2. The final bonus of £9 comes from an overall yield of 5%.



Please note that it is an example only and actual returns and bonuses may be very different; they will largely depend on how stockmarkets perform. The result of applying the overall yield may be less than the current bid price (see "Market value reductions" on page 10).

We apply different levels of overall yield for With-Profits Growth units bought in different periods (usually six-month periods). This means different final bonuses may apply to With-Profits Growth units in your bond that were added at different times.

In order to set the overall yields, we take 'sample units' added in each of these different periods. The sample units are chosen to be representative of the units of the bonds in your group. We calculate a 'target payout level' for the sample units from each period.

To help us to work out the target levels we:

- take the 'asset shares' of the sample units (see "Asset share" on page 11);
- add the investment returns we expect until the units are cashed in and the overall yield applied; and
- make the adjustment for the smoothing of recent investment returns described below, which gives us a 'smoothed asset share'.

We then take the initial value of the sample unit when it was added to the group of bonds. We calculate by how much this initial value would need to be increased each year over the life of the sample unit in order to achieve the target level. The overall yield is set as this yearly rate.

Overall, we aim that total payouts over many years are equal to the asset shares. The extra that we sometimes pay out because of guarantees would be on top of this.

## Smoothing

With-profits investing includes a special feature called 'smoothing'. The stockmarket goes up and down daily and can move a lot in a short space of time. We aim to smooth some of the effects of these short-term peaks and troughs. We only consider movements in the last two years. So smoothing will not lessen the effects on your return of longer-term changes in the stockmarket.

We use smoothing whenever the guarantee applies but it may also apply if you choose to move your investment from the With-Profits Growth Fund at other times. Smoothing is complex and more details of our approach are in our PPFM.

We constantly monitor investment conditions, and may change levels of overall yield at any time. For instance, we'd consider a change if asset shares move more than 25% away from the smoothed asset shares we had used for the current bonus rates. We'd also consider a change if it was necessary to limit losses to the With-Profits Growth Fund. We may limit the smoothing when setting overall yield rates to reduce the likelihood of a further overall yield change within the following six months.

Final bonuses can sometimes change very significantly, even within a few months, in spite of smoothing.

# What if I decide to cash in With-Profits Growth units when guarantees don't apply?

Normally, if you choose to cash in With-Profits Growth units then guarantees won't apply. This may happen because you decide to:

- switch out of the With-Profits Growth Fund into another investment fund;
- take fixed regular withdrawals that don't qualify for guarantees (see page 4); or
- cash in all or part of your bond.

Whatever the reason, we will still aim to give you fair value for your investment. However, there is no minimum guarantee of what your bond will pay and you will not get anything for the guarantees you are giving up. In fact, it is possible that you could get back less than you invested if markets are low enough.

How much you get back from each of your With-Profits Growth units will be:

- the bid price of the units, which includes the regular bonuses we have already added;
- plus any final bonus that we add;
- less any 'market value reduction'.

There may be a charge if you transfer your investment out of your bond early. This charge helps us to recover costs and is not covered in this guide. It will be described in the Key Features that we gave you at the start of your bond.

## Market value reductions

Our aim when making a market value reduction is to maintain a fair level of payouts to everyone investing in the With-Profits Growth Fund. We always apply a market value reduction where the result of applying the relevant overall yield (see “Final bonus” on page 7) is less than a unit’s current bid price. We refer to this as the ‘basic’ market value reduction. We may introduce an ‘additional’ market value reduction to take payouts below the result of applying overall yield to meet our aim.

We work out rates of additional market value reductions for each group of investors. We use the same representative sample units we use to set final bonuses. We will only set an additional market value reduction if the sample units’ asset shares are lower than the result of applying the relevant overall yield. We could do this even if we are not applying a basic market value reduction.

The size of the reduction is restricted by the terms of your bond. We will not set an additional reduction such that it takes the sample unit’s payout below its asset share. We constantly monitor investment conditions and the rate at which investors are cashing in With-Profits Growth units. We may change or apply additional market value reductions at any time to meet our aim of fairness.

In particular, we would introduce an additional market value reduction if it were necessary to avoid excessive losses to the With-Profits Growth Fund.

We’ll also check after not more than three months, and whenever overall yields are changed, to see if it should still apply.

# What affects how much I might get back?

## Asset shares

Asset shares help us decide the bonuses to pay and the market value reductions to apply. The way this works is described earlier in this guide. Very broadly, asset shares are an accumulation of the amounts invested. So when deciding what an asset share would be, we look at the following three main factors:

- the amounts invested in sample With-Profits Growth units (see below);
- when they were invested; and
- the past investment performance of the 'core assets' (see "Investment performance" overleaf).

We also make adjustments for:

- the regular deductions that we have made from asset shares as part of the process of paying for the guarantees we make to With-Profits Growth Fund investors;

- the With-Profits Growth Fund's profits and losses from the process of paying for guarantees (see overleaf);
- the With-Profits Growth Fund's profits and losses from the process of paying for smoothing;
- the charges we have made to cover the cost of managing your bond;
- any profits and losses from 'business risks' (see "What are the risks of investing in the With-Profits Growth Fund?" on page 13); and
- taxation.

We track asset shares of the With-Profits Growth Fund for sample With-Profits Growth units. We track them separately for the different groups of investors, including your group, and for units that were started at different times.

## Investment performance

This guide sometimes refers to 'core assets'. These make up the part of the With-Profits Growth Fund whose investment performance has an important effect on asset shares and therefore on what you will get back.

The performance will depend on, among other things, how much of the core assets are made up of each of the different types of asset. The mix of the core assets can be different for different groups of investors.

We currently aim to hold 85% of the core assets in higher-risk assets such as shares and property, to try to achieve higher returns. The rest is in lower-risk assets, such as fixed-interest bonds issued by the Government or by companies, and cash deposits that earn interest.

The performance of different types of asset varies considerably over time. So we may change the mix of the assets with the aim of:

- getting the best possible long-term performance; and
- making sure that the With-Profits Growth Fund can always meet its guarantees.

We include information about the mix of assets in the yearly statement we send you. It is also within the PPFM section of the Scottish Widows website. You'll therefore be able to see how we review and change the mix of the assets over time.

## Guarantees

We regularly deduct small amounts from the asset shares to pay for the guarantees. These deductions are added to an account in the With-Profits Growth Fund that is separate from the core assets. The account is used to help pay for any payments made that are greater than asset shares.

We set the deductions at a level we expect to cover the cost of paying for the guarantees. The size rises or falls as the expected cost changes. We use 'derivatives' to reduce the variability. Derivatives are specialist forms of investments and we apply strict controls over how we use them. The cost of the guarantees is likely to increase when there's been poor investment performance. Derivatives increase the money available to support guarantees at these times. This lessens the need to increase the deductions from asset shares. Derivatives reduce the money available when the investment performance is good and little support is needed.

The whole approach sometimes leads to profits and losses in the account. So from time to time we value the account to judge whether we expect there to be too little, enough or too much money in it. To balance the account we may adjust the asset shares and the future level of deductions.

## What are the risks of investing in the With-Profits Growth fund?

Your With-Profits Growth investment, by being part of our With-Profits Growth Fund, is exposed to 'investment risk'. This is the risk that the value of the core assets can fall as well as rise. There are other risks known as 'business risks'.

The main business risks for your bond come from the process of paying for the guarantees and smoothing that we make to other With-Profits Growth investors. The profits and losses from this process can increase or decrease the asset share for your group. This could increase or decrease the bonuses you receive.

With-Profits Growth units are unlikely to share in the profits and losses from other policies in the other parts of the with-profits fund, and vice versa.

There are naturally risks associated with your bond that apply to other sorts of investment and not just our With-Profits Growth Fund. Those other risks, such as the risk that the taxation may change, would also apply to other ways of investing your bond. This guide deals only with risks that are directly associated with your bond being invested in our With-Profits Growth Fund. You can find out about the other risks in the Key Features document you were given at the start of your bond.

# How can I get more information?

If you're still not sure about your with-profits investment, you should speak to your financial adviser or contact us direct. If you wish to contact us you can write to us at:

Scottish Widows  
PO Box 902  
15 Dalkeith Road  
Edinburgh  
EH16 5BU

Or you can call us on 0845 845 0845. We're open from 8am to 6pm Monday to Friday and from 9am to 12.30pm on Saturday. We may record and monitor calls to help us improve our service.

We'll write to you if we make a change to our approach to managing our with-profits fund that might have a significant effect on your plan. We'll also write if we change any of the 'Principles' in our PPFM. We'll normally include a replacement guide.

If you've any other with-profits investments with us that aren't covered by this guide, we'll send out your guide or guides for them.

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